

**TENNESSEE DEPARTMENT OF REVENUE
LETTER RULING # 03-10**

WARNING

Letter rulings are binding on the Department only with respect to the individual taxpayer being addressed in the ruling. This presentation of the ruling in a redacted form is informational only. Rulings are made in response to particular facts presented and are not intended necessarily as statements of Department policy.

SUBJECT

Sales and use tax on packaging materials for samples.

SCOPE

This letter ruling is an interpretation and application of the tax law as it relates to a specific set of existing facts furnished to the Department by the Taxpayer. The rulings herein are binding on the Department and are applicable only to the individual taxpayer being addressed.

This letter ruling may be revoked or modified by the Commissioner at any time.

Such revocation or modification shall be effective retroactively unless the following conditions are met, in which case the revocation shall be prospective only:

- (A) The taxpayer must have misstated or omitted material facts involved in the transaction;
- (B) Facts that develop later must be materially different from the facts upon which the ruling was based;
- (C) The applicable law must not have been changed or amended;
- (D) The ruling must have been issued originally with respect to a prospective or proposed transaction; and
- (E) The taxpayer directly involved must have acted in good faith in relying upon the ruling and a retroactive revocation of the ruling must inure to his detriment.

FACTS

[THE TAXPAYER] is in the direct mail advertising business. The taxpayer's corporate headquarters is located in [STATE-NOT TENNESSEE], and it has a fully owned distribution facility in Tennessee. The taxpayer prepares and distributes free samples to

demographic groups. The samples are provided without charge¹ and do not require the purchase of any additional products in the future. For certain promotions, coupons are included with the sample, but in these cases the recipient is under no obligation to utilize these coupons.

The taxpayer's customers are primarily large personal product manufacturers. The customers pay the taxpayer a fee to distribute samples of the customers' selected products to a pre-determined number of people within a specific target market. The taxpayer is responsible for identifying the location of those representatives of the target market, sorting and packaging the samples, and distributing the samples to the recipients. The taxpayer does not purchase the items included in the samples; rather, the manufacturers send the products directly to the distribution facility. The taxpayer will take several different products (usually 5 items) and place them in a small bag or cardboard box along with advertising materials. The completed sample packages are then packed into large shipping boxes and sent to various locations across the country. Corrugated cardboard boxes are used to ship the sample packages from the distribution facility. A typical shipping box can hold approximately 250 sample packages.

A commercial printer within the state of Tennessee creates some of the printed material included in the sample packages, and some of the printed material is printed outside the state.

QUESTIONS

1. Does the bag, box or cardboard carton containing the actual sample products qualify for the exemption for containers, wrapping, and packing material?
2. Are all of the shipping boxes, tape, and labels subject to Tennessee sales and use tax, or is only that portion of boxes, etc. that ultimately comes to rest within the state of Tennessee?
3. Is sales or use tax due on the printed material that is printed both inside and outside the state?

RULINGS²

1. No.
2. All of the boxes, tape, and labels are taxable.
3. Tax is due on the printed material regardless of where it is printed.

¹ In the ruling request, the term "gifts" is used in regard to the samples.

² See the "Special Note" at the end of the ruling for information regarding amendments to the statute by Ch. 357, Public Acts of 2003.

ANALYSIS

1.

Tenn. Code Ann. §67-6-102(a)(25), the definition of “retail sale,” contains the following exclusion:

(E) “Sale at retail,” “use,” “storage,” And “consumption” do not include the sale, use, storage or consumption of

* * * *

(ii) Materials, containers, labels, sacks, bags or bottles used for packaging tangible personal property when such property is either sold therein directly to the consumer or when such use is incidental to the sale of such property for resale;

The Commissioner has promulgated a rule, TENN. COMP. R. & REGS. 1320-5-1-.11, that addresses this issue. That rule states, in full:

(1) Items actually accompanying the product sold or shipped, without which the delivery of the product is impracticable on account of the character of the contents, and for which there is no separate charge, are not subject to Sales or Use Tax. These items include such things as containers, packing materials, labels or name plate affixed to products manufactured, and printed matter containing only directions for use.

(2) Sales of containers, wrapping and packing material and related products which actually accompany work done for customers, when the services are subject to the Sales or Use Tax, are exempt from the Sales or Use Tax. Sales of tangible personal property to persons who render services which are not subject to the Sales or Use Tax, are subject to the Sales or Use Tax.

(3) Charges made by dealers in this State for "gift wrapping" are subject to the Sales or Use Tax.

While the Commissioner is authorized to prescribe reasonable rules and regulations not inconsistent with the taxing statutes under Tenn. Code Ann. § 67-1-102, such rules and regulations may not enlarge the scope of either a taxing statute or an exemption. See, *Covington Pike Toyota, Inc. v. Cardwell*, 829 S.W.2d 132, 135 (Tenn. 1992); *Volunteer Val-Pak v. Celauro*, 767 S.W.2d 635, 637 (Tenn. 1989); *Coca-Cola Bottling Co. v. Woods*, 620 S.W.2d 473, 475-76 (Tenn. 1981). Therefore, the rule cannot create a tax exemption that does not exist in the statute. The statute and rule must be considered together. It is clear in the statute that a sale, either to the consumer or a sale for resale, is required in order to exempt the accompanying packaging. Here, no sale takes place

subsequent to the taxpayer placing the tangible personal property in the packaging, so consequently, the exemption is not available.

Further, it is clear under paragraph (2) of TENN. COMP. R. & REGS. 1320-5-1-.11, that the exemption for packaging does not apply to persons rendering nontaxable services. The taxpayer is performing a nontaxable service.

2. & 3.

Tenn. Code Ann. § 67-6-202 levies a sales tax on Tennessee sales. Tenn. Code Ann. § 67-6-203 levies a use tax on use of tangible personal property when used. Tenn. Code Ann. § 67-6-201, a statement of intent, states in pertinent part:

It is declared to be the legislative intent that every person is exercising a taxable privilege who:

(1) Engages in the business of selling tangible personal property at retail in this state;

(2) Uses or consumes in this state any item or article of tangible personal property as defined in this chapter, irrespective of the ownership thereof or any tax immunity which may be enjoyed by the owner thereof;

Therefore, in general, the taxpayer's use of the property is subject to either a sales or use tax. However, an important exemption, commonly referred to as the "import for export" exemption, is found in Tenn. Code Ann. § 67-6-313(a), which states:

It is not the intention of this chapter to levy a tax upon articles of tangible personal property imported into this state or produced or manufactured in this state for export.

There are a number of cases in which the appellate courts of Tennessee have reviewed this exemption.

Mere storage, in Tennessee, without any other activity occurring, does not remove tangible personal property from the import for export exemption. *Young Sales Corp. v. Benson*, 224 Tenn. 88, 450 S.W.2d 574 (1970). The temporary presence of tangible personal property on a Tennessee post office dock, where taxpayer had a right to possess the goods, was also insufficient to remove the tangible personal property from the import for export exemption. *Service Merchandise Co. v. Tidwell*, 529 S.W.2d 215 (Tenn. 1975).

In *Beecham Laboratories v. Woods*, 569 S.W.2d 456 (Tenn. 1978), the court did not permit the imposition of a use tax on the value of pharmaceutical samples that were stored in state, when portions of the samples were imported from out of state and other portions fabricated in state. In contrast to *Beecham*, in *Nasco, Inc. v. Jackson*, 748 S.W.2d 193 (Tenn. 1988), the court permitted the imposition of the tax on the purchase price of component parts that were fabricated by the taxpayer into other items for its own

use, where the component parts were both purchased in-state and imported from out-of-state. The court stated that the fabrication constituted a taxable use, distinguishing the issue involved from that in *Beecham*, stating:

The assessment in [*Beecham*] was predicated upon the taxpayer's use of the pharmaceutical samples in storing them in Tennessee, then withdrawing them from a Tennessee warehouse and distributing them to salesmen in other states. The case did not involve a sales tax, nor did it involve a purchase for resale by the taxpayer under a resale certificate.

* * * *

In *Beecham* the Court was concerned with the use of the materials after their fabrication or importation, not with the transactions by which the taxpayer acquired the components. *Nasco, Inc.*, 748 S.W.2d at 196.

Contrary to Nasco's argument, the Court determined that its decision did not render the import for export exemption meaningless. Rather, the Court stated that in contexts such as *Young Sales* and *Beecham*, the exemption was most important. *Id.* However, those cases did not deal with the use tax ramifications of the original acquisition of goods without payment of sales or use tax where no resale occurs.

The courts have also held that in-state sales (that is, where title or possession of the goods passes in-state) are not exempt pursuant to the import for export exemption. *See United Methodist Publishing House v. Woods*, 609 S.W.2d 501 (Tenn. 1980) and *Jack Daniel Distillery v. Jackson*, 740 S.W.2d 413 (Tenn. 1986).

Applying the above principles to the case at hand, the following results are reached.

First, items purchased in-state are taxable, regardless of whether the taxpayer later ships the tangible personal property to Tennessee or non-Tennessee recipients.

Next, items purchased from out-of-state, imported into Tennessee, merely stored in Tennessee, and exported, would not be taxable, pursuant to *Young Sales, supra*.

Finally, however, under the facts set out in the ruling request, the activities with respect to the tangible personal property exceed mere storage. The samples provided by the customers are combined into a package. While *Beecham, supra*, precludes the taxing of the storage of the completed package, *Nasco, supra*, holds that the taxpayer is making a taxable use of the tangible personal property it incorporates into that package.

Conclusion

Therefore, in accordance with the foregoing analysis, all packaging and printed materials that are used in assembling, preparing, and shipping the samples under the facts given would be subject to sales or use tax, without respect to the destination to which the completed sample packages are shipped.

SPECIAL NOTE

Ch. 357, Public Acts of 2003 has been enacted to enable Tennessee's participation in the Streamlined Sales and Use Tax Agreement. Ch. 357 will become effective no earlier than July 1, 2004. The amendments made by Ch. 357 do not impact the result of this ruling. The exemption for packaging material is not changed. The import-for-export exemption is retained, but uses slightly different language.³

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APPROVED: Loren L. Chumley
Commissioner of Revenue

DATE: 10/30/03

³ Tenn. Code Ann. § 67-6-313(a), as amended, will read: "It is not the intention of this chapter to levy a tax upon articles of tangible personal property imported into this state or produced or manufactured in this state for export without any use in this state so long as title, risk of loss, or possession passed from the seller to the purchaser prior to importation." Ch. 357, Public Acts of 2003, § 80.